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No. 99-1273

IN THE

# Supreme Court of the United States

AMERICAN STEAMSHIP OWNERS MUTUAL PROTECTION AND INDEMNITY ASSOCIATION, INC., WEST OF ENGLAND SHIPOWNERS MUTUAL PROTECTION AND INDEMNITY ASSOCIATION (LUXEMBOURG), CONTINENTAL INSURANCE COMPANY, THE UNITED KINGDOM MUTUAL STEAM SHIP ASSURANCE ASSOCIATION (BERMUDA) LIMITED, ASSURANCEFORENINGEN SKULD, LIVERPOOL & LONDON MUTUAL STEAMSHIP PROTECTION AND INDEMNITY ASSOCIATION LIMITED, AND MARINE OFFICE OF AMERICA CORP.,

*Petitioners,*

*v.*

UNITED STATES LINES, INC. AND UNITED STATES LINES (S.A.), INC. REORGANIZATION TRUST AND ASBESTOS CLAIMANTS,

*Respondents.*

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

## BRIEF FOR RESPONDENTS FULTON SYNDICATE SURVIVORS AND THE TRAVELERS INDEMNITY COMPANY IN SUPPORT OF THE PETITION


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## PARTIES TO THE PROCEEDING AND STATEMENT PURSUANT TO RULE 29.6

The parties to the proceeding are identified in the Petition for Certiorari (the "Petition"). This filing is submitted by the Fulton Syndicate Survivors and The Travelers Indemnity Company as respondents who support the Petition. The Fulton Syndicate Survivors are five former members of the Protection and Indemnity Insurance Underwriting Syndicate, New York, who were incorrectly sued in this action as Marine Officers of America Corp. By Stipulation dated March 16, 1993, Marine Officers of America Corp. was dismissed, and the Fulton Syndicate Survivors were substituted. The Travelers Indemnity Company was incorrectly sued in this action as The Travelers Insurance Company and has appeared under its correct name. Each of the Fulton Syndicate Survivors makes its disclosure pursuant to Supreme Court Rule 29.6 as follows:

The Travelers Casualty and Surety Company, formerly known as The Aetna Casualty and Surety Company, and its affiliates are subsidiaries of Travelers Property Casualty Corp., a portion of the stock which is publicly held, which is controlled by Citigroup, Inc., a publicly held company.

ACE Property and Casualty Company, formerly known as CIGNA Property and Casualty Company, formerly known as Aetna Insurance Company, is a publicly traded holding company.

The Great American Insurance Company is a subsidiary of American Financial Group, Inc., a publicly traded company.

The Hartford Insurance Group companies are subsidiaries of The Hartford Financial Services Group, Inc., a publicly held company.

The obligations of United States Fire Insurance Company arising from its participation in The Protection and Indemnity Underwriting Syndicate, New York, were passed to Marine Office of America Corporation (more commonly referred to as "MOAC" and misidentified by Respondents as Marine Officers of America Corp.), a subsidiary of The Continental Insurance Company which during the pendency of this action was purchased by CNA. CNA therefore responds for the obligations of United States Fire Insurance Company. The direct or indirect parent company of all the CNA companies is CNA Financial Corporation, a publicly traded holding company.

The Travelers Indemnity Company and its affiliates are subsidiaries of Travelers Property Casualty Corp., a portion of the stock which is publicly held, which is controlled by Citigroup, Inc., a publicly held company.

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## PRELIMINARY STATEMENT

This case is about whether the contours of federal jurisdiction may be impermissibly stretched to allow non-Article III judges to render final judgments on independent state-law contract claims in a bankruptcy proceeding. This Court has already emphatically stated that the answer is no, holding that the Constitution expressly protects litigants from such extra-judicial exercises of power. *See Northern Pipeline Co. v. Marathon Pipeline Co.*, 458 U.S. 50 (1982). Courts across the country have faithfully followed this edict in determining the bankruptcy courts' legitimate jurisdiction. In the decision below, the Second Circuit gravely departed from this Court's teaching and unconstitutionally conferred upon non-Article III bankruptcy judges the power to adjudicate as a "core proceeding" a traditional contract action regarding insurance rights that arises exclusively under state law.

While this case is cloaked in what may appear to be the technical trappings of bankruptcy procedure and insurance contracts, it raises fundamental questions of federal jurisdiction. For example, when should a traditionally common law claim involving breach of contract be finally decided as part of a statute-based bankruptcy proceeding? May a state-law claim be deemed "core" simply because its resolution would impact core bankruptcy functions? Should this Court's restrictive bankruptcy decisions be "narrowly construed" into extinction while the lower courts broadly expand bankruptcy court jurisdiction beyond constitutional limits? May litigants' rights to plenary decision-making by an Article III court and a jury trial be curtailed in the name of judicial efficiency? In holding that the bankruptcy court may exercise core jurisdiction over a debtors' alleged rights

to insurance proceeds, the Second Circuit deviated severely from this Court's decision in *Marathon*, and squarely disagreed with the Seventh Circuit's opinion in *In re U.S. Brass*, 110 F.3d 1261 (7th Cir. 1997).

Not surprisingly, the panel of the Second Circuit issuing this radical decision did not reach a consensus. The Court's opinion is authored by Judge Walker, who writes that a post-petition breach of contract claim may be "core" based on the impact the contract has on core bankruptcy functions. Judge Newman concurs in the result, but disagrees with the reasoning, and would issue an even more dramatic ruling that *every* post-petition breach of contract claim is a "core" proceeding. Judge Calabresi states that he is unsure of the correct approach for deciding when a contractual claim constitutes a "core" proceeding, but agrees that this particular breach of contract claim is "core" without further explanation. When three such esteemed jurists are so graphically at odds and uncertain over the right standard for deciding the parameters of federal jurisdiction, warning bells should sound that this Court's guidance is needed.

This Court should grant certiorari to establish the proper scope of the bankruptcy courts' jurisdiction, to harmonize a clear conflict among the lower courts, and to correct the injustice of subjecting present and future litigants to unconstitutional adjudication by a non-Article III court.

## STATEMENT OF THE CASE

The Fulton Syndicate Survivors and The Travelers Indemnity Company file this brief as respondents who support the Petition pursuant to Supreme Court Rule 12.6 (the "Supporting Respondents").

Like the Petitioners, the Supporting Respondents entered into marine protection and indemnity insurance contracts that allegedly provide coverage for certain asbestos-related claims asserted against the debtors (United States Lines, Inc. and United States Lines (S.A.), Inc.) and that are currently being defended by the debtors' reorganization trust. The insurance agreements were entered into prior to the debtors' petition for bankruptcy in 1986. The asbestos-related claimants do not have any judgments against or settlements with the debtors' trust. Rather, the trust seeks a declaratory judgment that the insurance contracts will provide coverage for the asbestos-related claims.

The Supporting Respondents urge this Court to grant review of the first question presented in the Petition, namely whether the bankruptcy court has jurisdiction to decide the trust's contractual claims for a declaration of insurance rights as a "core proceeding."

Because the Supporting Respondents' insurance policies do not contain arbitration clauses, we take no position with respect to the Petition's second question regarding the enforcement of arbitration agreements in the Petitioners' insurance contracts.

The Supporting Respondents otherwise adopt the Petition's recitation of the Opinions Below, the Statement of Jurisdiction, the Authorities Involved, and the Statement of the Case. *See* Petition, at 1-3. We offer the following additional points as to why certiorari should be granted on the "core proceeding" issue.

## REASONS FOR GRANTING THE WRIT

### I.

### THE SECOND CIRCUIT'S OPINION GRAVELY DEPARTS FROM THIS COURT'S TEACHING.

Section 157 of the Bankruptcy Code defines two categories of proceedings: (a) core proceedings, which the bankruptcy court may "hear and determine" and on which the court "may enter appropriate orders and judgments," 28 U.S.C. § 157(b)(1), and (b) non-core proceedings, "otherwise related to a case under title 11," which the bankruptcy court may hear, but for which the bankruptcy court is only empowered to submit proposed findings of fact and conclusions of law to the district court for *de novo* review, 28 U.S.C. § 157(c)(1). The primary jurisdictional question before the Second Circuit was whether the trust's adversary proceeding for a declaration of insurance rights may be deemed a core proceeding.

The Second Circuit correctly acknowledged that this Court's decision in *Marathon* provides the foundational rules for analysis. *Marathon* held that the broad jurisdictional provisions of the Bankruptcy Act of 1978 violated Article III of the Constitution by granting non-Article III judges the right to determine matters traditionally delegated to Article III courts or state courts. Specifically, the Court ruled that Congress acted beyond the scope of its authority in delegating to bankruptcy courts the power to decide claims asserted by the debtor for breach of contract, breach of warranty, misrepresentation, coercion and duress.

The Court premised its ruling in part on the distinction between public rights, for which Congress may delegate jurisdiction to legislative courts, and private rights, which may not be removed from Article III jurisdiction.

> [T]he restructuring of debtor-creditor relations, which is at the core of the federal bankruptcy power, must be distinguished from the adjudication of state-created private rights, such as the right to recover contract damages that is at issue in this case. The former may well be a "public right," but the latter obviously is not. Appellant Northern's right to recover contract damages to augment the estate is "one of private right, that is, of the liability of one individual to another under the law as defined."

458 U.S. at 71-72.

The Court also relied on the distinction between statutory rights, which Congress has the power to define, and private rights, which belong to the province of the Judiciary:

> [W]hen Congress creates a statutory right, it clearly has the discretion, in defining that right, to create presumptions, or assign burdens of proof, or prescribe remedies; it may also provide that persons seeking to vindicate that right must do so before particularized tribunals created to perform the specialized adjudicative tasks related to that right. Such provisions do, in a sense, affect the exercise of judicial power, but they are also incidental to Congress' power to define the right it has created. No comparable justification exists,

> however, when the right being adjudicated is not of congressional creation. In such a situation, substantial inroads into functions that have traditionally been performed by the Judiciary cannot be characterized merely as incidental extensions of Congress' power to define rights that it has created. Rather, such inroads suggest unwarranted encroachments upon the judicial power of the United States, which our Constitution reserves for Art. III courts.

*Id.* at 83-84.

The central principle in the Court's opinion is that private rights may not be removed from Article III jurisdiction. Accordingly, the Court concluded that the Bankruptcy Act improperly encroached upon the judicial power by vesting bankruptcy judges with unauthorized powers over Northern's state-created right. *Id.* at 84. The touchstone of the Court's analysis was that "Northern's claim for damages for breach of contract and misrepresentation, involve[d] *a right created by state law, a right independent of and antecedent to the reorganization petition* that conferred jurisdiction upon the Bankruptcy Court." *Id.* (emphasis added).

The Second Circuit's decision rightly quotes this language as *Marathon*'s principal holding. Petition Appendix ("Pet. App.") at 8a. However, Judge Walker's decision immediately proceeds to misstate the test as follows: "under *Marathon*, whether a contract proceeding is a core proceeding depends on (1) whether the contract is antecedent to the reorganization proceeding; and (2) the degree to which *the proceeding is independent of the reorganization*." *Id.* (emphasis added). Judge Walker incorrectly shifts from

focusing on the *rights* at issue (the driving principle behind *Marathon*'s analysis) and their relationship to the reorganization petition, to focusing on the *proceeding* and its relationship to the reorganization itself. As the opinion progresses, the focus shifts even farther away. In the only three paragraphs of the opinion that analyze the status of the trust's claims, Judge Walker concludes that "the impact these contracts have on other core bankruptcy functions . . . render the proceedings core." Pet. App. 10a. Thus, the Second Circuit moves from analyzing: (a) the nature of the rights, to (b) the relationship between the proceeding and the reorganization, to (c) the impact of the contracts on other bankruptcy functions. The end result is an amorphous test that turns on whether the court believes that the claims at issue are important to the bankruptcy judge's other rulings. Of course, the outcome of such a standardless inquiry can and will vary from one court to another.

In this case, the Second Circuit concluded that the contract claims were core because the insurance agreements contain "pay-first" provisions whereby the policyholder must pay any judgment or settlement before seeking indemnification from its insurers. Because insolvent insureds have in the past tried to circumvent these provisions through "creative" payment schemes, the Second Circuit held that the bankruptcy court would need to decide whether a chosen payment plan would satisfy the insurance contracts, which could affect the court's decisions regarding priority of creditors and equitable distribution of the estate. *See* Pet. App. 12a.[1] The court's analysis is purely hypothetical:

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1. The Second Circuit also stated that the bankruptcy court would have to decide "the amounts payable under the insurance (Cont'd)

if the policyholder attempts to use a creative payment scheme, the bankruptcy may have to decide on its validity, which may affect other creditors' rights. From this string of events, the court concludes that the contracts have too significant an impact on the court's core bankruptcy functions not to be core as well.

What the Second Circuit loses sight of is that the phrase "core proceeding" is not a metaphorical term to describe "important" proceedings. *Marathon* teaches that courts may only classify proceedings as core based on an analysis of the *rights* at issue. Here, the trust is suing on contractual rights that existed before the bankruptcy proceeding and are independent of the reorganization petition. Whether the trust may recover for sums paid to asbestosis claimants under the policies is not a matter created by the bankruptcy statutes. It is a matter originating from the terms of the policies and traditionally decided under rules of contract law. If the policyholder were not insolvent, these rights would be decided in a state court under local rules of law. This is the trademark of a "private right," the adjudication of which cannot be delegated to a non-Article III judge without the parties' consent. *See Marathon*, 458 U.S. at 90 (Rehnquist, J., concurring) (debtor's suit involved "the stuff of the traditional actions at common law tried by the courts at

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(Cont'd)
contracts." Pet. App. 12a. However, the Second Circuit acknowledged in the preceding paragraph that simply augmenting the debtor's estate is not a basis for classifying a proceeding as core. Pet App. 11a ("where the insurance proceeds would only augment the assets of the estate for general distribution, the effect on the administration of the estate [is] insufficient to render the proceedings core"). Accordingly, this factor cannot support the Second Circuit's decision.

Westminster in 1789. There is apparently no federal rule of decision provided for any of the issues in the lawsuit; the claims of Northern arise entirely under state law.").

Not only is the Second Circuit's decision wrong, but the standard it adopts for classifying "core proceedings" is an unacceptable deviation from this Court's *Marathon* test. As stated in its opinion, the Second Circuit apparently believes it has the liberty to limit this Court's decision — even to the point of evisceration. Pet App. 7a ("We have held that 'core proceedings' should be given a broad interpretation . . . and that *Marathon* is to be construed narrowly."). Judge Newman's concurring decision takes this liberty even farther. He writes that he would issue a blanket ruling holding that all claims for breach of contract arising after the filing of the bankruptcy petition are core proceedings. The basis for his decision is judicial efficiency: "[i]n my view, the efficient functioning of the bankruptcy system will be better served by a bright-line rule that treats as core proceedings all suits alleging post-petition breaches of pre-petition contracts." Pet. App. 18a.[2] Surely, this Court's

2. Judge Newman also confuses the *Marathon* standard for determining when rights are "antecedent to the reorganization petition." Judge Newman wrongly focuses on the litigant's cause of action and argues that where a contractual breach occurs after a petition is filed, the plaintiff's asserted right is not antecedent to the petition. Pet. App. 21a. However, *Marathon* centers on the nature of the right (in this case, the right to a contractual remedy) — not the right to sue. As Judge Walker rightly states, "the critical question in determining whether a contractual dispute is core by virtue of timing is not whether the *cause of action* accrued post-petition, but whether the *contract* was formed post-petition." Pet. App. 9a. Where, as here, the debtor or its trust is seeking to enforce contractual rights that accrued pre-petition when insurance policies were issued, its claims are precisely those that *Marathon* proscribes from final adjudication in the bankruptcy courts.

instructions regarding the proper scope of federal jurisdiction should not be overridden by concerns for expediency. As this Court cogently explained in *Marathon*, litigants' rights to have their claims decided by a proper tribunal are too sacrosanct to be sacrificed on the altar of judicial efficiency.

Judge Calabresi's concurrence demonstrates the inconclusive state of law on the core proceeding issue and the problems that arise in the absence of a clear standard. Judge Calabresi identifies the large gap between Judge Newman's bright-line rule and Judge Walker's case-by-case approach, but concludes that the court need not resolve the issue. Instead, he states: "Like Judges Walker and Newman, I have no doubt that this particular post-petition breach of a pre-petition contract is core. That is all I need to decide the instant case." Pet. App. 24a. Judge Calabresi does not offer any additional explanation for his core proceeding decision, making it unclear what standard he applied to reach his conclusion.[3]

The parameters of federal jurisdiction should not be subject to the vagaries of individual judicial reactions regarding what is important to the bankruptcy court's powers, whether courts will be more efficient if they do not have to engage in an individual analysis of their jurisdictional authority, and whether a claim looks like a core proceeding. This Court's guidance is needed to establish the correct standard for classifying claims as core and the proper boundaries of the bankruptcy courts' jurisdiction.

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3. While Judge Calabresi indicates that he is more inclined to follow a case-by-case approach, he also suggests creating a middle ground, in which there would be a rebuttable presumption that all post-petition breaches of contract are core. Pet. App. 24a.

## II.

## THE SECOND CIRCUIT OPINION CREATES A DIRECT CONFLICT WITH THE MAJORITY OF OTHER APPELLATE COURTS, PARTICULARLY THE SEVENTH CIRCUIT.

The Supporting Respondents adopt Petitioners' argument regarding the conflict between the Second Circuit and the majority of other circuits on the core proceeding issue. *See* Petition, at 11-14. We write here separately to highlight the direct split between the Second and Seventh Circuits on the specific question of whether insurance coverage claims constitute core proceedings.

In *In re U.S. Brass Corp.*, 110 F.3d 1261 (7th Cir. 1997), Chief Judge Posner authored a unanimous opinion for the Seventh Circuit deciding a dispute strikingly similar to the instant case — in the exact opposite way. There, the debtor Eljer and its insurers were involved in several declaratory judgment actions regarding whether the debtors' policies provided coverage for claims by third parties related to Eljer's defective plumbing systems. As in this case, the policies were issued prior to the filing of a bankruptcy petition. Eljer sought to remove all the cases to bankruptcy court, and the bankruptcy judge remanded four of the cases to state court and abstained in the remaining two. The Seventh Circuit upheld the bankruptcy court's decision, based in part on its conclusion that the insurance proceedings were non-core. The Seventh Circuit applied the same test for classifying core proceedings enunciated in *Marathon*:

> Core proceedings are actions by or against the debtor that arise under the Bankruptcy Code in

> the strong sense that the Code itself is the source of the claimant's right or remedy, rather than just the procedural vehicle for the assertion of a right conferred by some other body of law, normally state law.

110 F.3d at 1268.

Following this correct standard, the Seventh Circuit ruled that Eljer's contract-based coverage claims arose from state law and could not qualify as core proceedings, notwithstanding the importance of the coverage question to the debtor's bankruptcy case:

> Eljer's claimed right to insurance coverage is a creation of state contract law and one that could be vindicated in an ordinary breach of contract suit if Eljer were not a bankrupt. The fact that it is an important right to the bankrupt — Eljer claims to be seeking $500 million in insurance coverage — is irrelevant. "Core" is a defined term in the Bankruptcy Code, a term of art, rather than a metaphor. The impact of a claim on the size of the debtor's estate is a criterion of whether a claim is related to the bankruptcy and is therefore a noncore proceeding. So Eljer has it backwards — arguing for classification as a core proceeding on the basis of a criterion for classification as a noncore proceeding.

*Id.* at 1268-69 (internal citations omitted).

Unlike the Second Circuit, the Seventh Circuit rightly maintained its focus on the nature of the rights, not the impact

of the proceeding on the bankruptcy court's other functions. Here, the nature of the right does not arise from the bankruptcy statutes, but from the contracts and the state law governing their interpretation. If the debtors were not bankrupt, these claims could be litigated independently of the reorganization; the Bankruptcy Code is merely a vehicle for asserting them in federal court. The assertion of the claims in bankruptcy court, and the fact that their outcome may be significant in allocating the debtors' estate, is not enough to render them core. In ruling to the contrary, the Second Circuit badly distorted the proper test. As with the debtor in *U.S. Brass*, the Second Circuit relied on considerations to classify the insurance claims as core that are relevant only to whether the claims are non-core.

In addition to the direct split between the Second and Seventh Circuits, the Supporting Respondents note that a number of decisions by the lower courts in the First and Third Circuits have specifically held that an action by a debtor or trustee against the debtor's insurer is a non-core proceeding. *See, e.g., Pozzi v. Merchants and Business Men's Mutual Ins. Co.*, 1992 WL 122904 (E.D. Pa. June 2, 1992) (debtors' declaratory judgment action concerning rights under insurance policy is non-core proceeding); *In re Ramex Int'l, Inc.*, 91 B.R. 313 (E.D. Pa. 1988) (trustee's cause of action for declaratory judgment under insurance policy issued pre-petition to debtor is not core proceeding); *In re R.I. Lithograph Corp.*, 60 B.R. 199 (D.R.I. 1986) (debtor's action for pre-petition breach of insurance contract based on refusal to pay claim is non-core).

## III.

## THE SECOND CIRCUIT'S DECISION WILL CAUSE HAVOC IN THE BANKRUPTCY COURTS.

The decision below gives rise to an unconstitutional situation in which the bankruptcy courts of the Second Circuit will be free to exercise core jurisdiction over claims not properly within their authority. The conflict between the Second Circuit and the other courts of appeal will lead to an unacceptable schism in which debtors in one circuit will have far-reaching powers to sweep all of their potential claims into a single proceeding finally adjudicated in the bankruptcy court. Aside from the moral hazard of encouraging forum shopping, the Second Circuit's aberrational decision raises the much more significant problem of improperly subjecting litigants to final judgments by judges without legitimate authority to preside over their disputes.

The deep respect for the federal judicial system in this country is founded in part upon the courts' careful delineation of their jurisdictional authority. In order for all parties to submit to the courts' power and for final judgments to have binding force, litigants must have faith that the forum in which they litigate is the proper authority to hear their claims. Similarly, litigants rely on the right to jury trial and plenary hearings by federal judges who are insulated from external pressures by life tenure and undiminished salaries. These guarantees are not lightly regarded; they are imbedded in the Constitution as the bedrock of our judicial system.

The Second Circuit's decision in this case creates unacceptable inroads into the vigilantly preserved contours of Article III jurisdiction. Rights traditionally deemed to arise

from the common law will now be swept into binding adjudications in legislatively-created bankruptcy courts based on their perceived importance to the debtor or the appeal of efficiency. If the decision below remains standing, this Court's prior teachings on the proper scope of the lower courts' jurisdiction will be sorely eroded, and litigants will be subjected to unconstitutional exercises of federal judicial power on an ad hoc basis. The Court should not countenance such a distortion of the letter and spirit of the Constitution, *Marathon*, and 28 U.S.C. § 157.

## CONCLUSION

For the reasons set forth above, and those provided in the Petition, the Court should grant review in this case. The parameters of the bankruptcy courts' jurisdiction are too important to leave in a state of flux. As the law currently stands, this Court's prior rulings are being eviscerated, a conflict exists among the courts of appeal, and bankruptcy judges and litigants are left floundering in state of uncertainty. The Court's guidance is required to bring uniformity to the lower courts on the most fundamental judicial question of all: when and under what circumstances they have the power to act.

Respectfully submitted,

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